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UniCredit S.p.A. (UNCFF) Q2 2023 Earnings Call Transcript

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UniCredit S.p.A. (OTCPK:UNCFF) Q2 2023 Earnings Conference Call July 26, 2023 5:00 AM ET

Company Participants

Andrea Orcel - CEO
Stefano Porro - CFO
Magda Palczynska - Head, IR

Conference Call Participants

Antonio Reale - Bank of America
Andrea Filtri - Mediobanca
Giovanni Razzoli - Deutsche Bank
Britta Schimdt - Autonomous Research
Ignacio Cerezo - UBS
Delphine Lee - JPMorgan
Hugo Cruz - KBW

Operator

Good morning, ladies and gentlemen. Before I hand over to Magda Palczynska, Head of Investor Relations, a reminder that today's call is being recorded. Ma'am, you may begin.

Magda Palczynska

Good morning and welcome to UniCredit's second quarter 2023 results conference call. Andrea Orcel, our CEO, will lead the call. Then, Stefano Porro, our CFO, will take you through the financials in more detail. Following Andrea's closing remarks there will be a Q&A session. Please limit yourself to two questions.

With that, I will hand over to Andrea.

Andrea Orcel

Thank you, Magda and thank you all for joining today. I'd like to start the call with a heartfelt thank you for all the employees of UniCredit that continued to deliver as we have quarter-after-quarter. Thank you, all.

The global political and economic environment continues to be marked by uncertainty with concern regarding the impact of inflation, higher rates and transition to sustainability within a new geopolitical environment, yet so far in 2023, we within 2022, with European economy is outperforming our prudent assumptions. The European banking sector has remained resilient, with sequential concerns around banks not **recurring**.

Liquidity has remained stable, pass-through and cost of risk more benign and profitability at elevated levels. We continue to push into the future, the expected shocks within this environment UniCredit's excellent results are a demonstration of a resilience of not only Europe, but of the European banks. Yes, risk remains and inflation combined with a possible further economic slowdown and the development of new technology needs to be managed. So we remain vigilant. We take pre-emptive actions, prudent and ready to adapt.

But what this presentation will demonstrate is the excellent progression of UniCredit unlocked and of our industrial and cultural transformation, but our people are leading the evolution and doing so as one team united by the same principle, the same values and with the same mission.

The vision driving that mission is for UniCredit to be the bank for Europe's future and a new benchmark for banking. Let's start our presentation with slide two, I guess. Is it working? 1 second. Okay, let me start with a snapshot of our current results. This show just how well we are progressing towards realizing that vision.

We have delivered our 10th consecutive quarter of profitable growth, the best second quarter and first half ever. Underlying net profit in the first half of the year was €4.5 billion or in excess of that. This is adjusted for €230 million of integration cost that we are expensing to continue supporting our operational efficiency improvements in the face of inflation whilst becoming more agile and self-funding significant investments. Net revenue rose 38% year-over-year. This is especially impactful. Sorry, we seem to be having a problem with slide, one second. Here we go. Sorry. Yeah. Let's see if they stay. Yes. Okay.

So net revenue rose 38% year on year. This is especially impactful given the drag from targeting quality growth, one that shows risk, discipline, improvement of mix and a focus on EVA positive transaction. Costs fell 1% and RWA 7% year-on-year in spite of gross, inflation and our investment for the future. The effectiveness of our operational and capital levers is shown in our 39% cost income ratio and our 8% net revenue on RWA ratio. Both are best ever, industry-leading and a result of improvement on both variable of the ratio, so both numerator and denominator.

So far this year, our return on tangible equity at 13% CET1 is at 21%. It is still at 17%, considering the excess capital that we still carry. Our CET1 reached 16.6%, structurally higher than our target of 12.5% to 13%, whilst at the same time we will have distributed in excess of €15.5 billion between 2021 and 2023, well above our initial target.

This is thanks to our much higher than initially expected profitability and organic capital generation. Indeed, we generated 210 basis points or €6.5 billion of capital in the first half alone. The strategy we're implementing is uniting our bank as one empowered franchise, capable of delivering consistent quality, profitable growth and outsized distribution over the long term.

As such, we are upgrading both our net income and distribution guidance respectively, to equal or greater than €7.25 billion and €6.5 billion, while absorbing yet upsized integration cost of €500 million and continuing to increase our CET1 year-over-year, all providing a strong foundation and outlook for 2024, as we expect to be broadly in line with the increasing higher bar set this year, we've clearly identified levers to achieve it.

What you're seeing with this result is the combination of a sector benefiting from generally supportive macro, some of which is structural, as we're not going back to negative rates and the large contribution from the relentless execution of UniCredit unlocked. The latter is what continues to drive our differentiation versus peers and enables us to beat expectation. Let me take you again through its essence, understanding it is understanding our transformation to date and our further potential.

Let's start with our winning strategy to achieve our vision. We have a group-wide determination to put clients at the center to understand what they want today and what they will need tomorrow. We serve them across three foundational countries, boosted by ten of the fastest growing and most innovative markets in Europe coming together as one.

This is a bank that represents a new and emerging Europe powered by a renewed single group mindset that truly unlocks the unique value for our clients and other stakeholders of being pan European. We provide our clients with a differentiated service that combines local reach with European interconnection and group-wide product factories that leverage an ecosystem of best in class partners, powered by an increasingly harmonized, forward-looking digital data and operations across our group. All is underpinned by solid principle and values that our people chose, live and breathe day to day.

Then we move to our ongoing industrial and cultural transformation, unique in that from within and employee led. We are strengthening our client proposition, distribution power and product factories while streamlining our organization, processes and way of working across all banks, all supported by our technology evolution.

We continue to invest in the business for the long term, making the necessary structural changes to be future-proofed and resilient. This allows us to support our communities through social programs, our clients and people to go through challenging times and our commitment to use and education. This approach serves all of our stakeholders well while delivering exceptional targeted financial outcome. As we continue to strive for excellence and execute relentlessly on UniCredit Unlocked, I am confident that our financial performance is set to continue through 2023, 2024 and beyond.

Let's turn to Slide four. Let me now take you through how we are deploying our strategy in further detail. Clients UniCredit Unlocked is primarily driven by around our 50 million clients across Europe, serving them and their communities locally, but benefiting from tools available to a group of our size and nature.

For most of our franchise countries, experts make up 50% of GDP. So our footprint is a unique gateway to the continent and possible expansion. We have overlaid this with industrial actions designed to ensure our clients not only connect, but also have access to premium tailor-made products, access the way they prefer.

This is supported by investments in our network, which we continue to upgrade and technology aiming to create the branch of a future in which an omnichannel approach combines a digital offering with passionate skilled people delivering best in class solutions, all within a higher quality and seamless client experience.

Our clients are served by 13 banks who are leaders in their own market. We have refocused our previously inward looking organization towards our clients. We have reunified our client franchises, harmonized group segmentation and return coverage and day-to-day decision to our banks and within our banks to the frontline. This model relies on both a clear unified framework of reference and our diverse talent who have the best understanding of the local market and dynamics. Talent which is critical for us to attract, retain and develop, which is why we hired around 2,000 people and we are providing them with circa 30 hours of training to maintain pace within digitization, product development, risk and ESG.

Each market is now equally served by group product factories, which we pulled out from the individual banks and centralized. These in-house factories leverage our group-wide scale and scope, also to support an ecosystem of top class partners. The most recent example is Mastercard. We signed a ground-breaking partnership in June the first time any large commercial bank had put in place a single card exclusive multi-market strategy of this scale in Europe. This partnership underscore our one UniCredit approach and are further unifier across all of our market.

The centralization of our factories and group-wide partners, combining with delayering, simplification of processes and way of working, training and putting back decision capabilities in the right places are delivering the divisional result you have witnessed today and in the last 10 quarters, best-in-class, in each market, in each business.

All of these pillars are being facilitated and enhanced by a gradually more streamlined and group-wide approach to technology and operation. The first phase of our digital evolution is nearing completion, taking back control of our heavily fragmented and outsourced technology, bringing it in house and selectively investing in it. We have hired more than 700 developers since 2022 and are upscaling our people to ensure that we have the right capabilities engaging our providers from a group standpoint, instead of individually and streamlining the way of working to lower cost and most importantly, time to market.

We have invested in cleaning and simplifying products and processes, freeing up resources, time and investment dollars, which can be repositioned towards what we really need. The second phase will be the gradual transformation to a modern, digital and data-driven organization, which will see the acceleration of automation, design of new tools and best-in-class platforms to improve our client responsiveness and more efficiency in the increasing of our consumption of technology. All of this is united by a holistic culture driven by core values and a common set of principle chosen by our people and embodied in our actions.

Our industrial and cultural transformation has powered our last 10 quarters, delivered differentiated performance, and rebased our key financial metrics. We now have a sustainable competitive advantage that we are determined to further consolidate. Let me take you through our new transform core financial KPIs and their drivers.

We believe we have cost leadership. This is critical to maintain a differentiated level of profitability, particularly given recent and prospective inflationary pressures. It is also critical to maintain our edge over fintechs and other market players. We have moved from force to efficiency leadership in Q1. This is a structural change versus the past and is driven by targeted cost reduction that does not affect, but rather invests and propels the quality of our revenue growth.

In absolute terms, we have reduced our cost base since 2017 by 18%. Critically, however, since 2021 this was done while substantially propelling and increasing both gross and net revenue, rather than shrinking them. We aim to continue and even strengthen this competitive advantage.

Quality revenue growth, we transformed both the growth and quality of our earnings. We moved from revenue laggard to revenue leader, delivering 10 successive quarters of top tier quality growth. We fundamentally transformed our ability to grow our revenue base, while improving our mix. Targeted quality revenue growth has meant being disciplined on risk, delivering EVA positive new business and focusing on fees and other capital light EVA positive sources.

Net revenue to RWA improved from 10th to third, whilst fees to RWAs improved from fifth to second as we're strengthening our factories. We have and will continue to address weaknesses generated by past retrenchment, but so are selling or constraining quality businesses.

We have made significant progress in rebuilding our high value added client content in a number of ways. Firstly, organically by hiring best-in-class talent attracted by our ability to deliver 15 million clients across Europe in a captive fashion. This is the case in both advisory and capital market and client risk management, demonstrated by the caliber of talent NineHouse and the visible results. These are targeted to our existing client base.

Secondly, by selectively internalizing critical part of the value chain, for example in asset management building central product selection and packaging, able to deliver projects such as Nova and One Markets. Thirdly, through our two way partnership with best-in-class product provider such as Allianz, Azimut and more recently, Mastercard.

Finally, we are reviewing further opportunities of growth, for example in payments both corporate and retail, where we see a significant opportunity and in unit linked, where we could internalize our dominant business in Italy. All of this requires significant investment in talent, in training, in technology, to both power group-wide factories and local distribution channels and deliver seamless integration between them. Let me give you an example to explain that point.

Let's take insurance. We have already rationalized our providers from nine to four and transformed them into partners. Today Allianz designs best in class protection products tailored for our clients. Together, we have trained our people and provided insights to our clients. The result is a step up in our Italian protection market share to 14%.

We're taking it even further. An integrated tech platform at group level is being launched, allowing real time access to product with streamlined processes and technology solution. This will further power our growth in the segment. Our transform quality revenue capacity is another competitive advantage that we will continue to focus on.

Structural lower cost of risk; over the past few years, our gross net NPs have fallen dramatically respectively to 2.6% and 1.4%. Our underlying cost of risk has structurally declined from at least 40 basis points to 50 basis points to 20 basis points to 25 basis points, so subject to confirmation within a longer time series. Indeed, our underlying cost of risk, excluding Russia and overlays between 21 and in 2023 year to date, has been well below 20 basis points, reaching single digit basis points over each one of the last six quarters.

It has benefited from a particularly benign environment and write-backs from repayments, which underscore how conservative we are on staging, classification and provisioning generally. This is due to the substantially higher quality of our credit portfolio as compared to the past that we have markedly accelerated since 2020.

Second, the substantial more conservative absolute and relative to peers both backward and forward looking staging and provisioning policy, we are covered much higher in every NPE stage. We believe we have moved firmly at the forefront of our peer group in this matter and are better prepared than any to weather the current macro and geopolitical uncertainty.

As a result, cost and cost of risk are much more within our control now in the next few years than most of the market had realized. We are prepared with this healthy provision and overlays in a quality credit portfolio to provide a solid buffer and positively differentiate cost of risk, both for now and in case the market turns. This is another competitive advantage and we are determined to continue strengthening it.

Capital excellence, our transform capital efficiency has been a major contributor to our sustainable performance and we ranked first on this measure relative to peers in Q1. This has three main drivers. First, we focus on deploying, sorry, slide. We focus on deploying capital above the cost of equity. 77% of corporate RWAs are now to SCBA positive clients as we improve the profitability of our legacy portfolio and our discipline in new business.

Second, we improve the profitability of our commitments via crosssell and pricing or ultimately exiting or securitizing position where accretive. Third, we are growing capital-light products. This is yet another competitive advantage that supports our return on tangible equity and organic capital generation. We are determined to continue building upon it.

Our P&L advantages combine with those of our balance sheet, creating performance with strengths. Our CET1 remains best-in-class among peers. We continue to grow capital in spite of our best-in-class distribution, thanks to our outsized organic capital generation. Our liquidity ratio remains strong, sustainable and well above peer average, allowing better management of margins.

We maintain a high quality credit portfolio with conservative proactive staging and provisioning, further improved by high overlays and lower default rate. We are focused on investing wisely to maintain profitable risk-adjusted return for the long term to the benefit of all our stakeholder and in many forms.

These last two slides have sought to explain what a dramatically different group UniCredit is today, despite being less than two years into our strategic plan. Our commitment to continuing this fundamental and holistic transformation remains, as does our commitment to delivering strong, sustainable result and distribution. It is our knowledge of how much more this transformation can unlock that gives us confidence in the future beyond the effect of this positive macro.

Let's now get back to the present. This is our tenth consecutive quarter of quality profitable growth. We have balanced our three levers to deliver this in a sustainable fashion. Net revenues rose significantly in both the half and the quarter, driven by quality NII growth and a tightly managed pass through.

Fees remain robust, especially if we exclude the impact of lower current account fees in Italy that had not yet been waived by all banks. This is €20 million adverse per month and cost of risk at very levels, both given macro and the new change UniCredit I have just described.

Of particular note is the dynamic of our deposit pass through below expectation at circa 24% and showing signs of approaching more normalized levels outside of Italy. This supports our new pass through guidance. We have been able to more than compensate the inflationary pressure on cost, both in the half and in the quarter while continuing to invest. Integration cost enable us to continue on this path, and we're stepping them up.

The positive momentum in our gross operating profit continues again beating expectation. It rose close to 52% in Q2 and 42% in H1. Our capital excellence continue with both outsized capital generation and further consolidation of best-in-class CET1.

UniCredit return on tangible equity continues to rise and we are surpassing our peers on this metric, having significantly lagged until a few years ago. At the same time, thanks to our substantial share buyback at depressed valuation, we are further propelling a very significant per share value creation. We are fairly unique in this respect.

Let me take you now through each country or region. Our Italian business had yet another excellent quarter, demonstrating its ability to deliver sustained quality, profitable growth and outstanding returns well above peers. Net revenue rose 19% year-over-year to €5.2 billion, gross revenue up '23. This was driven by NII growth of 66%. Thanks to strict management of the pass through.

Fees were down 5.2% year-on-year, mostly due to active relief provided to customer on current account applied since April. Without such relief, our fees would have been down only 2.6%. We saw good result in asset under custody, products and excellent ones in protection as was commenting.

Costs fell 2% in Italy, thanks to our continued focus on simplification and streamlining and despite continuing investment both in the front line with Circa 370 new hires in 2023 and in our branches with Circa 550 completely renewed branches from the beginning of 2022. RWAs were reduced by 12%. As a result, we achieved a strong operating and capital efficiency with a 35.5% cost income ratio and 9.1% net revenue to RWAs. Profit before tax rose 31% to €2.9 billion, RoAC exceeded 25% and the region contributed 86 basis points, or €2.7 billion of organic capital generation to the group.

Our commitment to our community, clients and employees remain undiminished this quarter, delivering amongst other things, the launch of a second tranche of UniCredit per l'Italia a €10 billion package to support clients, both individuals and business. We also introduced a package of up to €1 billion to support those impacted by the May floods and offered mortgages dedicated to energy sustainability to help family and individuals in the realization of their housing projects.

Today's strong set of result and the very concrete step we have taken to support families and businesses confirm that financial and social objectives are not in conflict, demonstrating that UniCredit can deliver for the benefit of our investors and of Italy as a whole.

Germany; Germany's structural transformation continued to power excellent result. Net revenues were up 13% year-over-year. Gross revenues were up 14%. This was driven by NII up 9% and fees up 5% driven in part by the successful delivery of our capital-light corporate financial advisory business and also asset management fees.

Cost fell nearly 5.3% in Germany with the ongoing transformation more than compensating for inflation and setting a new run rate for the future. RWAs were down 5% year-over-year. We also achieved a very strong operating and capital efficiency in Germany with a 41.7% cost income ratio and 7.3% net revenue on RWA ratio.

Profit before tax was up 36% at €1.3 billion. RoAC reached 18.7% and the region delivered 57 business points or €1.8 billion of organic capital to the group. We continue to invest in our clients and our frontline delivering the introduction of a cashless advisory branch model for local high quality customer advice.

Our corporate client portal has released further functionalities including the introduction of power of attorney self-service. This quarter has seen Germany continue to deliver simplification with integration of COO and Digital to deliver a full end-to-end and customer-focused approach. All of this is resulting in US being named top employer in Germany for the 13th time in a row and receiving the EDGE Move certification for D&I in 2022.

Central Europe, Central Europe's quarter was defined by consistent stability and delivery of high profitability. Net revenues were up 29% year-over-year, gross were up 27%. This was driven by NII up 39%, fees slightly down following general market pressure but up in transaction and financing. Costs remained flat year-over-year as the discipline continue across all countries and our focus on operating and capital efficiency was reflected in a €38.5 cost income ratio and 7% net revenue on RWA ratio.

Profit before tax was up 65% to €1.1 billion. RoAC was 20.6% and the region delivered, sorry, delivered 29 basis points or €0.9 billion of capital organically. We have made significant progress in retail digitalization signing up 67,000 new clients in first half, '23 in Czech Republic and Slovakia alone. We launched our first green mortgage covered bond in the Czech Republic and succeeded in obtaining the Green Start Certificate in Slovenia. We established the inaugural Girls Go Finance Event to strengthen girls' understanding of finances through our partnership with Teach For Austria, an initiative we intend to roll out across all of our Teach For All markets.

Eastern Europe; Eastern Europe profitability continued at pace this quarter, driven by business intensity and further efficiency gains. Net revenues were 47% year-over-year, with gross revenue up 31%. This was powered by both NII up 44% and fees up 4%. Our focus on active cost management continued to balance a continuous efficiency drive with investment in digitalization and automation. Our focus on operating and capital efficiency was reflected in a 34.1% cost income ratio and 9.2% net revenue on RWA ratio.

Profit before tax landed at €800 million. RoAC was 34.4% and the region delivered 18 basis points or €600 million of capital organically. We continue to invest in our network and business and customer transformation. This quarter, we introduced cashless branches in Bulgaria. We effectively balanced our S with our E commitments, rolling out a number of social programs for vulnerable groups focused on use in Romania, whilst also supporting the employees of this group. At the same time, we saw €170 million of new lending to renewable energy within Bulgaria.

Client Solution as we have discussed extensively about our investment in our factories, we will now provide just some key highlights and additional data for this quarter. Client solution revenue was resilient in the first half and relative to a strong base. Revenue fell 3% year-on-year and would have been up 1% excluding Russia. Corporate solution revenue fell 2% in the first half but grew by 3%.

Excluding Russia, overall fees were up 5% year on year with RWA consumption down 13%. Driving record profitability, transaction and payment revenue rose 12% year on year, while advisory and capital markets was up seven and reached the number one fee ranking in its home market.

Client risk management revenue fell 13% but would have been flat excluding Russia. Specialized lending was down 9% year on year, but flat normalized for TLTRO and one large one off. Individual solution revenue fell 4% year-over-year. Strong performance in protection continued while life insurance remained under pressure, particularly as we kept discipline around RAMOPRIMO. Brokerage and custody showed the strongest growth up 90% led by strong client demand for bond products.

Our commitment to our purpose begins with us and the actions and decision we take with respect to our own people, our clients and those communities that we are intrinsically part of. These actions were evident in the overview that I gave for each one of the regions, action targeted for the need and challenges of each local market, but beyond that, whether it is closing the gender pay, the partnership we forged to fight discrimination, supporting arts and culture, the work of our foundation, which will now invest this year alone €20 million in project to support, use and education of our UniCredit start lab, our commitment to deliver on our purpose a central tenet of our strategic plan.

I am now handing over to Stefano, who will provide more detail on our numbers on H1.

Stefano Porro

Thank you, Andrea, and good morning, everyone. Let's turn to Slide 18. Before I take you through the second quarter '23 results, please note the my comments are based on a year-on-year comparison, that second quarter '23 versus second quarter '22, unless otherwise noted. Let's look at the P&L in more detail, starting with revenue.

In the second quarter, we generated a record €6 billion revenue up 25%, mainly thanks to an increase in net interest of about €1 billion. Revenue in second quarter includes the €60 million negative impact from current account fiat pricing in Italy. Trading activity at €0.5 billion, up 32%, supported by the fixed income, currency and commodities business.

This quarter also benefited from higher treasury contribution. We took €0.1 billion impairments in profit for investment in the quarter, mostly from participation in Russia, Italy and Austria. Systemic charges in second quarter include €27 million tax on extra bank profits in Hungary as the government changed the methodology for the 2023 calculation as flagged last quarter. Let's turn to the next slide.

Let me share some highlights of UniCredit's strong balance sheet and robust liquidity position. Our favorable liquidity position, starts with the structure of our balance sheet and a loan-to-deposit ratio well below 100% at a stable and sound 90%. We have a resilient and diversified deposit base. More than 80% of our deposit are from retail and SME clients. Our deposit market share across the group is stable. The decrease in volumes in the quarter are mainly driven by corporate, using their cash buffer and our focus on pricing.

Thanks to our superior liquidity profile and balance sheet strength, we are in a position to be able to do so. Retail deposit volumes were broadly stable. Clients kept diversifying their saving into more asset under custody products, in particular BTPs in Italy, and they are keeping their asset with us with our TFAs up €11 billion in the quarter. Total deposits are still comfortably above pre-2020 levels. We expect the overall deposit volume to continue slightly declining in 2023 as we prioritize pricing management and quality net interest income, and as there is further rotation to asset under custody or asset under management. This is also reflected in our deposit beta, which I will discuss in more detail later.

Our liquidity cover ratio at second quarter '23 was above 100% the after TLTRO repayments, in line with our managerial target range at 125% to 150%. We have a large liquidity buffer with about €215 billion liquid assets effectively unchanged, compared to the quarter before. Let's turn to Slide 20 and focus again on the quarter.

Net interest income was €3.5 billion, up 6% quarter-on-quarter We continue to experience a positive net interest dynamic driven by higher loan rates and still low deposit beta. Net interest margin at 2.1%, up nine basis point in the quarter. Customer loan rates are up 43 basis point in the quarter across our regions, leveraging on higher interest rates and thanks to our commercial actions. Average client loan volumes relevant for net interest are down €4.3 billion in the quarter, driven by Germany and Italy, mainly short term loans for SME and large corporate.

Clients demand for lending has declined in the first half of the year and is expected to remain contained as a consequence of higher rates. We remain focused on more profitable capital efficiency loans while supporting our clients. Loan volumes are bolstered by €3.3 billion in USG lending in the quarter as we continue assisting our client screen transition and support social initiatives. The increase in the customer deposit rate is limited to 20 basis points for the quarter, while the average Euribor three months was up 73 basis points. Our average deposit pricing is below the system across most of our regions.

Average commercial deposit decreased by €8.9 billion in second quarter, mainly in Germany, but also Austria, driven by a few large corporates. We expect retail deposit market share to remain stable, while corporate deposit dynamic will continue to be lumpy. We have updated our managerial interest guidance and sensitivity. Based on a 3.75% ECB deposit facility rate from the third quarter, remaining stable thereafter and a deposit beta below 40% and the end of the year, we expect an improved full year '23 net interest income guidance at least €13.2 billion. This is mainly thanks to a better average deposit beta for the year slightly below 30%. The observed deposit beta for the group for both side and term deposit in second quarter is around 24%, an increase as we expected, but less than assumed. The slight increase in the quarter is mainly driven by Austria.

In Italy we still have a low level of circa 11%. We continue to see a shift from site to term deposit. However, site for the group is still 75%. The recent TLTRO maturities did not have a material impact on the market or UniCredit funding cost. The net interest income sensitivity for a one percentage point of deposit beta is about €130 million at current rates and deposit volume assumption. The net interest income impact from an ECB deposit facility rate increase of 50 basis point is about €0.3 billion, which also depends on our client behavior and competitive dynamics develop.

If the ECB starts to reduce short term rates, our deposit replicating portfolio, which is factored into our net interest income guidance will continue to support our net interest income. At today's interest rate levels, the run rate net interest income will be supported by about €0.3 billion per year.

Let's turn to Slide 21. Fees in second quarter were €1.9 billion, up 2% excluding the current account fee reduction in Italy were €60 million in the quarter, in line with our guidance. Continuous strong performance in transactional fees and better financing fees more than offset still subdue investment fees. We are well-diversified and balanced as you can see from the year-on-year development of the different component parts of our fees.

Transactional fees were up 1% or 11% excluding current account fee reduction in Italy, thanks to robust payment and card fees driven by client activity and property and casualty insurance growth in Italy. Repriced current account fees in Italy will continue to negatively impact transactional fees by about €20 million per month to yearend 2023.

Financing fees are up 2% thanks to a recovering global capital market activity and loan fees in Germany more than offsetting higher securitization cost stemming from our active portfolio management strategy and lower credit protection insurance linked to retail mortgages in Italy. Investment fees were down 3% on reduced management fees due to lower average asset under management stock, mainly in Italy. Asset under management gross sales. And upfront fees are stable. Client aging fees were stable as we keep on supporting our clients in defending their business outcome in this volatile environment.

Let's turn to Slide 22. We reduced costs 1.2% year on year, while inflation in our footprint was above 8% in first half 2023. Let's take a closer look at HR and on HR cost developments. HR costs down 1% year on year benefiting from lower FTS down 4.6% to 73,000, supported by earlier retirement plans becoming effective in Italy.

The trade union agreement in Italy is currently being renegotiated on a national level, while the German one is valid until mid-2024. Austria closed the annual agreement at the beginning of 2023, and the mandatory salary increase of about 8% is already included in second quarter '23. Results non HR costs are down 1.4% thanks to a tight cost management and remediation actions compensating the overall inflation impact. Although integration costs are not included in the cost line, we incurred €214 million in second quarter '23.

We expect for the full year to have around €0.5 billion. This is to further allow us to reduce the structural long term cost base of the group while keep hiring and investing. Let's turn to Slide 23. Cost of risk was at very low two basis point in the quarter, supported by our still low default rate at 0.8% and the good performance on repayments and back to Bonnies. We kept our overlay LLPs on performing loans stable in the quarter at around €1.8 billion to be used for any shocks or to be released in the following two years.

Our underlying cost of risk net of overlays in Russia has reset and was single digits basis point over the last six quarters. The cost of risk in the quarter includes our Biannual IFRS nine macro scenario update with corresponding LLPs stable in Italy. The cost of risk of 21 basis points reflects ongoing sound asset quality. Cost of risk for Germany and Eastern Europe is low at seven and four basis points respectively. In Central Europe, we had the negative cost of risk because of MP repayments leading to LLP releases.

Our updated spillover analysis and details of our commercial erect exposure can be found in the Annex and confirm the soundness of our group risk profile. The group's expected loss on your business at 27 basis points also confirms the credit quality of our portfolio origination and our discipline is ingrained in our organization.

Let's turn to slide 24. Our underlying asset quality remain robust gross MPs at €12.1 billion, reduced by about €0.5 billion in second quarter. The MP reduction was driven by unlikely to pay portfolio disposal in Italy, which lowered the share of unlikely to pay impasse due.

Still comparable AI at 76%, MP coverage ratio at 48%. Broadly stable quarter on quarter MP coverage does not include overlays on performing loans which come on top. Let's turn to Slide 25 in second quarter, our risk weighted asset stood at €295 million, down €4 billion quarter on quarter, driven by continued active portfolio management measure worth €3.5 billion including securitization and the reduction of low performing businesses.

Risk weighted assets are down €22 billion year on year and are expected to remain below €300 billion also by year end. Let's turn to slide 26 in second quarter, we organically generated 101 basis point of capital, 77 basis point from net profit and 24 basis point through our active risk credit asset management way ahead of our plan. We completed the two point 34,000,000,001st share by back tranche and launched the remaining €1 billion second tranche for 2022. As of 21 July, UniCredit purchased shares equal to 6.5% of the share capital for a total consideration of some €2.4 billion.

Before I hand back to Andrea one item of note the Hungarian extra profit tax has been extended to 2024 as well and we it to be broadly in line with this year amount which was €75 million. Please Andrea, the floor is yours.

Andrea Orcel

Thank you, Stefano. I will now finish with some closing remarks we're now incorporating in. The improved assumption on rates and pass through as well as cost of risk. We are also further stepping up in the execution of Unicreated unlocked key industrial drivers. As such, we are upgrading again our net profit guidance for 2023 to at least €7.25 billion, an increase of around 1.6 billion from our initial guidance at the beginning of this year, despite absorbing €500 million in integration costs that were not budgeted at the beginning of the year.

Accordingly, our distribution intention for 2023 has improved to a minimum of €6.5 billion, €1.25 billion higher than our guidance at the start of the year. Ass cash dividend shall be at least €2.4 billion up 25% year-on-year versus €1.9 billion of 2022 and circa 35% up.

Based on the current number of shares, we are confident that we will maintain this profitability and distribution at broadly this level for 2024. Given our clear levers to deliver within this reference macro, sorry, this would translate to total distribution of €22 billion between 2021 and 2024 versus the €16 billion we announced with UniCredit unlocked while substantially increasing at the same time.

Our CET1 and our capital that should also benefit shareholders in new course. We have our sights also firmly set on future success with clear management priorities that I have already touched upon. We will. NII reduction by managing passthrough across each one of our banks, focusing on targeted volume growth and pricing optimization, and reaping the benefit from our asset and liability management strategy.

We have a number of ways to further increase our fee generation across advisory and capital markets, private banking, private the banking payments, and overall insurance. This will provide further support to NII compression when it occurs.

Our cost reduction remains targeted effective in further declining our cost base while continuing to fund our investments. We will execute this reduction by simplifying processes, rationalizing our organization and in new and renegotiated supplier contracts.

At group levels, our cost of risk should remain structurally low, thanks to our disciplined quality growth, the quality of our credit portfolio and its coverage complemented by conservative provisioning we are well prepared to maintain our cost of risk below 25 business points; even in eventual forecasted peaks resulting from unexpected exceptional and we have €1.8 billion or 40 basis points of additional overlays that we charge to our P&L in '21 and '22 that can be used exactly for this eventuality, reducing the peak we continue to pursue through RWA efficiency.

We will continue our disciplined management actions, remain focused on capital light products, and increase further the efficiency of our loan backbook as it rolls. These are our current priorities for 2024, which should enable profitability and distribution broadly in line with 2023. This will be supported by the significant foreseen tailwind of a reduction in our systemic charges and benefit in lower integration cost.

Let's now turn to the last slide. Before I close, I would like to take a moment to give you my view on how we look at distributions. We're often described as having outsized distribution, but our ability to offer attractive returns is based on our extremely strong organic capital generation. We're in an enviable position and fairly unique position, a compelling and growing shareholder remuneration an increasing CET1 ratio, even post distribution, and very significant per share value growth.

Our approach to striking the right balance between cash dividend and buybacks is determined by our prevailing valuation and with a view to having a sustainable increase in the dividend year by year. As our valuation improves over time, we're open to gradually increase the cash dividend payout.

To ensure a more attractive cash dividend yield, we are able to deliver outsized distribution versus our peer group whilst significantly increasing our CET1. Our distribution are not relying on distributing our excess capital. That said, we also recognize that we are carrying an ever increasingly larger amount of excess capital that the market seems to currently value at zero. We will return this excess to shareholder if no better use of the capital can be found. This success also gives us confidence in being able to maintain our 2023 distribution for the foreseeable future. Regardless of external factors, this is an advantage relative to our peers.

Thank you, and I will now open for questions.

Question-and-Answer Session

Operator

[Operator instructions] The first question is from Antonio Reale with BOA. Please go ahead.

Antonio Reale

Hi, good morning, everyone. It's Antonio from Bank of America. Two questions for me, please. The first one is on capital and the second one on the net profit outlook for 2024. Starting with the first question, which is actually a follow up based on Andrea's remarks. When I look at your increased distribution, even as it stands, you will end basically every year with quite a large stack of excess capital and growing. Your policy has been quite clear.

On Slide 30, I think you show the payout as a percentage of organic capital generation, which is now at 70%, but even then, it's starting to look somewhat conservative. What do you think it takes for you to increase that payout to 100% of your organic capital generation, because with that, you wouldn't even be paying any of the excess capital out? At the risk of sounding a bit harsh here, you've marked down your Russian exposure. You have large overlays. You don't really guide to any significant regulatory headwinds going forward. So why not pay 100% of what you generate given, as you said, you have a lot of excess, and so I'm wondering why they need to grow it further. That's my first question.

The second question is to do with your net profit guidance. You're guiding to be broader in line to this year also in 2024, so at least €7.25 billion. Could you talk about how you see the drivers year on year in 2024 versus 2023? I think on Slide 29 you provide some very interesting color on a qualitative basis. Can we maybe talk through and help us understand better the bridge in profitability across those three drivers? Thank you.

Andrea Orcel

Okay. So thank you, Antonio. So let's start with capital and distribution and everything else. So firstly I take note and noted on the fact that if we look at our capital as a proportion of organic capital generation or as a proportion of net income, we seem to becoming less aggressive, meaning that if we look at the proportion of distribution, vis-à-vis net income in '21 and then in '22. Then the indication we're giving for '23 we're distributing ever less relative to net income, a little bit more relative to organic capital generation, which is what drives us. Why are we doing that, because we're not at the end of the year.

We have been very clear in saying that our distribution are equal or above to the numbers we're giving you and the numbers will be finalized when we reach the end of a year. We see what the future will take us in 2024 and we have all the elements to take a judgment call. But in general we maintain the fact that we will maintain prudent distribution, which for us are keeping them within our guiding capital generation with an eye on what they are as a proportion of net income, as net income seems to be an industry practice, but I am committed in fulfilling my commitment on distribution, actually on beating them through results.

On the excess, it's something different. At some point we will complement what we do organically recurrently and ordinarily, which is what I'm talking about now, with an integration of return of my excess capital over time to complement what we're doing. We are on the second quarter of the year. There is still a lot of uncertainty at the moment. The guidance is what it is. We will refine it as we go through the year.

The second thing is 2024, which I think is quite critical. I think that the whole UniCredit is delivering as best it can for 2023. The role of a management team is to prepare for 2024 and beyond. So as we look at 2024, we look at it in this fashion. Firstly, NII will have an adverse headwinds, assuming that our macro is correct, given that interest rates are going to have plateaued, will have plateaued, and the path through is going to continue to converge.

Now, that effect for us is a little bit greater than peers in Northern Europe, a little bit less than our peers in Italy, given that the markets where the passthrough has the biggest effect are Southern European markets. Now, this adverse effect will be partially offset by what it will be offset by selected volume growth in SMEs and other segments and products across the franchise in retail, which we are in a position now to do at even positive levels.

This is also helped by the fact that we continue to grind down our backbook and that grounding. Is an adverse on our loan growth but it's not going to last forever at the same rate. The second thing is that we were, as we said several times originally, let's say under replicated and conservatively replicated, as we bring up our replication to the right run rate for this level of rates, because we expect them to go down at some point, we are bringing in additional revenue.

And Stefano has mentioned it at the current level of interest rate is €300 million of additional revenues per year. If rates increase, that's more. So these factors together we're anticipating a reduction of NII but a reduction of NII that is less than what you may think because of these offsetting factors.

Still a reduction then the second thing is what happens on revenues overall? Well, we are anticipating strong or solid fee income as we continue to invest in our factories. The fee income from our factories is dependent on the macro.

Much lower rates means better fees in asset management, in life insurance and in other things. So there will be a beta effect against positive beta effects on the fees of setting in part the negative beta effects on NII and in our case, let's say propelled by all the investment we're doing in asset management action, in payments, in advisory and capital market, in client risk management, et cetera, et cetera. So that will bridge the gap further or compensate the gap depending on the speed of pass through flowing in our account so that's the revenue line then below the revenue line.

We have two other factors. One factor is cost. We're determined to keep our cost base down this year and flat or down next year. We said we had an ambition to still hit UniCredit unlocked pre inflation. That means our cost line still has further room to go down and that I think is a competitive advantage because when NII will reverse people who have not managed their cost line will get a margin squeeze. People who have will not and we will keep on driving this down. I think that's a competitive advantage and we will deliver that. That could give us 150,000,000 of lift again, then we have a cost of risk.

Cost of Risk we are not anticipating a meaningful divergent between what the cost of risk will be for the whole year of '23 and '24. Why that? Because even if we assume an increase in cost of risk underlying due to the deceleration of the economy, we think that the more conservative level of provisions that we have relative to benchmark and the release, the gradual release of overlays.

To bash down that peak will allow us to remain at a cost of risk. That is in the ballpark of what it will be this year, given what we know today. So as you see, revenues will go down a lot less or not depending on what we do on the outsetting fashion costs will go down so that's a positive cost of risk remain the same.

Now, we have two other buffers that we believe we are unique in having. Number one, as a GC fee we have very significant reduction in systemic charges coming in next year. I think Stanford [ph] has indicated more than one times that is several hundreds, millions of dollars, €300 million to be the case and we also have that we have told you that this year €7.25 billion are done absorbing. So after having expensed €500 million of integration cost to support our efficiency gains, but I don't have to do €500 million in immigration cost next year. So theoretically I have another €500 million in there.

When you pull it all together, you see that. Of course, we don't have a perfect picture of what the future will be, but based on what we do today and the levers we have that we control, we think we can remain broadly in line year on year and everything is quite granularly explained within our management team.

Operator

The next question is from Andrea Filtri with Mediobanca. Please go ahead.

Andrea Filtri

Yes, thank you for taking my question. I've got more of a question on the strategy of how you guide the bank. Everything is going ahead at full steam for 10 consecutive quarters. You continue to upgrade your shareholder remuneration and we're at a point where, with the last fireworks, the share price today is flat. Could you react to the eventual stale price in sort of setting up a reaction function to the share price calibrating share buybacks in a targeted manner to essentially take opportunity of this lack of sensitivity of share price to the results and to the way you see things evolving. Thank you.

Andrea Orcel

Well, if I had the answers, I would do your job, but Andrea, what can I say? I do what I control. Let's look at the silver lining. Number one, I'm never going to sell a share and number two, I am buying stock which is undervalued by the bucket load and the people who are in it are going to see explosive distribution yield and at some point consistent, resilient, recurrent, repeated outperformance is going to trickle in.

Why is that today, now being serious? I have my personal understanding of my personal views given my last job. My personal view is that the market has very few specialist investors in banks and how many of us are still left after a decade of drought? Not many. And the money from specialist investor is limited, is long only and moves very slowly as it should. Most of the money that makes the difference is from generalist and generalists by definition don't understand banks.

So what they do is they invest through the cycle on macro rates and rates are capped. They're going down cost of risk cycle and at least looking at the past, which is the one way of looking at it in my opinion, the cost of risk is going to explode. So if you are looking at macro drivers, looking at past performance of European financials, that's what you're doing in order to buy banks. And you are seeing a substantial increase in share price which has occurred anyway.

You're not moving money into it or you are reticent to move money into it. And if on top of it you're based in the United States, you're looking at your own system, which for once is a lot weaker and less resilient than the one of Europe. But you don't know that from the standpoint of what you're looking at. So that's my rationalization. All the management team can do is continue to prove people wrong every quarter by delivering on results ahead of expectation, if we can. And then at some point, hopefully, it trickles into the share price. Thank you, Andrea. Thank you. The next question is from Chris Hallam with Goldman Sachs. Please go ahead. Yeah, good morning, everybody.

So my first question, it's a bit of a follow up from Antonio's earlier question, but just around the phasing of revenues in prior quarters, you've talked about Q2 or Q3 this year being the peak for NII and for fees growth really kicking in from the second half of next year. But given what we're seeing on betas as well as a more benign macro backdrop, are either of those time frames moving at all i.e. NII peaking later or fees recovering earlier? That's my first question.

And then second, you talked about being a benchmark bank and rot for the first half as over 20% at 13% quarter one. So there's clearly a lot of operating leverage in the business right now given all the momentum in NII. But I wanted to hear your thoughts about what you think a sustainable level of return on capital could now be for unit credit through the foreseeable future given the progress you've made on cost and capital efficiency.

And if that longer term Rot is higher than you previously expected, whether that changes where you want to take the business and where you want to invest capital. Okay, so peak and II. So peak and AI is we still feel it's probably, as we said, between Q two and Q three pick and II is driven by two factors, obviously. One is rates. When are we going to peak in rates?

And we all assume an increase in rates this week, and some of us assume there will be another one, but very few assume there will be yet another one after that I don't know, but we are reaching the back end of a rates increase cycle. The second thing to which banks are now a lot more, let's say, sensitive to is pass through. As rates have gone where they are, pass through is continuing to converge.

So, as we said in the presentation, we see signs of normalization of path through outside of Italy. That is due to the fact that they have reached levels that are, let's say, much more in line to what they were when rates were at this level in the past. Actually, in many cases they have surpassed that, but then at that level it normalizes. In Italy not yet the case. We're still lagging behind, and we're lagging behind because of the structure of the market and the structure of the client base.

But the progression is inevitable. And we are conservatively assuming in our numbers that the path through in Italy will exceed what was the case at similar rates in the past. So, given that rates are at the end of the increase and pass through continuing to grind up, especially in Italy, we think that second to third is the peak.

So far we have been overly cautious on passthrough and so. I don't exclude that the peak is third to fourth if the pass through grinds up slower than we are anticipating this quarter, given that the rates are still going up, but that's the order of magnitude. Okay, then the dynamic is that getting into next year, you're going to have rates that, contrary to the past, we assume staying at higher level for a little bit longer than we were anticipating before.

A few quarters, and then that pass through, given that the exit rate is lower than we had anticipated, takes a little bit more time to get to the levels we were anticipating before. So the support on the commercial side of NII is a little bit better than before on the non-commercial side.

So let's call it the replication and the commercial side with volume growth, we think we can offset some of that. That's why the scenario is more benign than we were anticipating in 2024. Fees? Fees are progressing and it depends on the factory, if you want to put it this way.

If you look at protection, we're talking increases depending on the reference time of 50, 70, 90% volume growth. If you look at our market share and protection, we went from the low single digit to 14% of the market. So that is occurring. Obviously, the base of start was low, but the base of start, when you're growing volume at that rate, does not stay low for a long time. It becomes visible quite soon. If you take asset management, we're still being grinded down, but at the same time, that is giving us time to roll out our initiative, Nova, one market, and other things that we're doing to internalize more of a value chain.

So that is something that. Is going to offset. And when Asset Management cycle comes back in, we think we're going to grow faster than people expect because of this internalization. Then we have payment. I think it's premature to look at the numbers, but I think it will be a contributor advisory capital market and client risk management has given us a lot of satisfaction. And we think that now it's plugged on our captive franchise and delivering.

Let's see how the market goes, and so life insurance, we are going to perform, in my opinion, a little bit less well than Peer because we have a much more cautious view on Ramo Primo, which is high volume and high fees, and we're much more focused on unit Linked, which is the market where we have a market share above 40% in Italy and that we're looking to potentially internalize in the next in time, which takes it will take time for us to do that. If that compromise is confirmed, that alone will bring a significant portion of additional other income into our P&L, so all of these things are small, incremental things that are increasing our fee and other income incidents.

On revenues that is currently a bit masked by the excellent performance on NII. The other one was sustainable. Rote. Yeah, that's really what I asked myself. If I take RoTE at 13% and I take an environment of rates that is structurally higher than what we have seen in the last decade and this is a very important point that I think is also missed. The rate cycle may be peeping out, but we're going to go to you tell me 2.5, 2.75, 2.25 positive rates for a commercial bank going from minus 50 to those numbers it's massive.

You have 60, 70, 55, whatever it is of your P&L that is now production in production and yields, and that combines with a focus gross on EVA positive, has an incremental impact on your rote. So without, if you ask me, a number of gut feeling, we need to aim something around 15% on sustainable basis with a real cost of capital when everything stabilizes 1011, these kind of numbers, maybe twelve, I don't know.

But we are determined to exceed the cost of equity and to exceed it by a margin. And I think we can do that, maybe a couple of remarks. Thank you very much. You mentioned also the timing. So the RoTE tangible equity excluding the excess capital for this year, we gathered for around 17%.

Considering that we guided for a profitability for next year broadly in line, you can also draw the consequences in relation to the return on tangible equity for 2024. In relation to the fees, we are not expecting the growth in the second half because all the elements highlighted by Andrea, so all the commercial actions, the normalization of the rates and also an increased level of GDP with the positive impact on the client activity is expected for next year so for '24.

Operator

The next question is from Giovanni Razzoli with Deutsche Bank. Please go ahead.

Giovanni Razzoli

Good morning. Thank you for taking my questions, another question on the profitability, the NII and in general the return on tangible sustainable return on tangible equity. Can I summarize your detailed comments on the evolution of the profitability of doing credit in saying that we should not believe that the NII people should necessarily present the peak of the profitability for unique trade because if I take all the points that you have mentioned, seems like you do have several levers to 24 and afterwards to still grow your profit or maintain it at the same level with a profitability that is going to be more significantly above your cost of capital.

So I was wondering whether this short sentence can summarize your thoughts. And the second question on more detail on the 2024 cost base. If I'm not mistaken, you seem to assume that your ambition is to keep the cost base for '24 as flat. That in my view would be a great achievement. I was wondering first of all, whether I got it correctly. And secondly, seems like in Italy there are clearly strong pressure to increase the cost of employees. I was wondering how to square this possible inflation in the salary in Italy, which is a target of stable cost base for 2024.

Andrea Orcel

Thank you. Okay, so peak and AI profitability. So our job is to try and offset the peak NII and reversal with other levers. And I think that that in our case is the result; one of good normalized deliver, but also all the actions that we're doing with UniCredit unlocked. So that means that without repeating all the things we can offset some of the NII reduction or some of the impact on NII from rates and pass through more gross in volume of the segments of clients and products that we want better replication because we were more replicated before.

Less replicated before and that is adding better fees as we continue to invest in our factories and we continue and that will be significant, lower cost and a cost of risk that going forward will be structurally lower than it has been in the past. To that you're adding that when we are through with a lot of the actions, we are going to have run rating some 800 million more between systemic charges and avoided or no longer necessary integration cost that can support some of the gap.

But it is clear that the challenge is to keep it stabilized to this high level and then over time find a new gross trajectory. Obviously the macro is better than I am telling you now the upside exists but at the moment we see what we are cost is. If you look at what has happened in '21, in '22 and now in '23 we have seen act the inflation and attacked the efficiency of a group since day one front loading and aggressively streamlining their organization.

You can't just cut cost across the board. You need to cut cost in a disciplined and surgical fashion. We have done that, we have supported that with hundreds. In integration cost. And we continue to take down what we take down a headcount significantly. Look at our headcount when we start and what it is today. We take down the non HR cost which are linked to all the contracts that we have. We had providers with 19 different contracts at Unicredited.

Now we go for one and bring significant offsetting on cost reduction given volumes and other things. So cost has been an obsession of ours, but it has been an obsession on of others that is executed while keeping a very attentive eye to continued investment and to reinvesting in the front end and in digital, so that it doesn't affect negatively revenue. It actually supports the further growth.

This approach has still quite a bit to run, certainly all of '24 and certainly all of '23 -- sorry, certainly all of '23 and certainly all of '24. It's premature to see. What we do in Italy will be totally consistent with agreement with the trade unions through pre-retirement and through whatever the negotiation of a new contract is, which we have seen coming for a long time and we have already prepared for.

Operator

The next question is from Britta Schimdt - Autonomous Research. Please go ahead.

Britta Schimdt

Yeah, hi there. Thanks for taking my questions. Just two for me. Can you just confirm again, did you mention that you will start addressing the excess capital position at the end of 2023? I guess depending on any inorganic investments you would like to undertake on some of your factories. Or would this rather be left for a little bit later?

And then secondly, just coming back on the cost point, can you just reiterate what sort of cost savings you anticipate in your billions for 2024 and what underlying inflation trends you expect, given also the wage bargaining that's still outstanding in Germany?

Andrea Orcel

Thank you. Okay, so excess capital position, obviously, is dependent on how much capital we're going to distribute this year, which will be equal or in excess of €6.5 billion. What we have said that we're committed to is whatever that distribution will be, our CET1, that performer for total distribution was 14.9% at yearend, 2022 will be no less, actually will be materially more.

So whatever the distribution that we do, we will have materially more CT One at the end of this year. That means that our excess capital, you can calculate, is about €1.5 billion. It's about €3 billion per point above 12.5%, 13% and that's what we are carrying. Going into 2024, we are set to do exactly the same i.e., we will have distribution that are broadly in line with the one of this year, given the condition that I have discussed in terms of profitability and everything else, and organic capital generation.

And we will target again to distribute while not reducing the excess capital also, the CET1 that we will have accumulated at the end of '23. So if you look at the trajectory, we've gone from the 13.5% area, then we have climbed to 49%, we will be above 49%, and then we will climb again to above whatever numbers we have at the end of this year. That is what we are doing with the ordinary distribution. Clearly it leaves us room to improve them because we are, I think, one of the very few, if not the only one to distribute and increase CT One.

At some point we're going to distribute and not increase CT One and then at another point we're going to distribute and give back to shareholders the excess capital. Most peers are in the third phase, we are in the first phase and we need to flow through the other two, which gives us very strong confidence on the absolute amount of distribution being defensible for the long term on cost, cost saving.

Where are we? So inflation first as a reference, inflation in our footprint 2023, about 7.1% excluding Russia, 5.5% in Eurozone, 6.2% in Italy, 6.1% in Germany. Inflation in 2024 expected 3.1% in our footprint, 2.4% in Eurozone, 2.4% in Italy, 2.8% in Germany. This is the reference points that we're using and on the reference point that we're using, we will continue. So this year we will decrease cost year on year from 2022 to 2023 and in '24 the minimum we're aiming to do is to keep them flat.

If we can, we're going to go below. And how are we going to do that? With continuous streamlining, simplification way of working, deburocratization of the organization, targeting processes that used to have 25 steps and no automation. And we are going to end to end automated process. So it's a long grading hygiene that we roll and roll and roll process after process, releasing resources and supporting these changes. Clearly the axis of FTE are negotiated with every trade union in every market where we are and are consistent with those negotiations. No more, no less.

Operator

The next question is from Ignacio Cerezo with UBS. Please go ahead.

Ignacio Cerezo

Hi, good morning and thank you for taking my questions. The first one is on Germany around asset feels to me that it's probably the country that pre imposed war has probably suffered the largest slowdown in terms of their macro environment basically within the Eurozone, but we are not really seeing any signs of TT ratio. And you seem to allocate actually a small portion of the overlays to the country. What gives you the comfort or how can you reassure the market basically run again, Germany not being a negative outlier within the asset quality picture in the group.

And then the second thing shorter if you can give us updated view on plans on Russia, I've kind of perceived a little bit of higher noise from the regulator around the need to get out of Russia for all the European banks. What is your view here? Thank you.

Andrea Orcel

So let me take Russia while Stefano will take the rest. So on Russia, facts as opposed to perception, credit has reduced 69% of our exposure in Russia since March 2022. That's €4.3 billion. I don't think anybody else has done anything like that. Okay. The impact of in this quarter alone I think we have compressed locally another billion. We continue to grind down. What we're doing there is to be consistent with local laws and sanction and with the sanctions and the directives that western governments give us and the strategy is identical to what we have said. It's a gradual, progressive, orderly reduction of our exposure towards the country. That's what we do and it has been quite successful. We will continue to do that.

In terms of added attention, I think the attention is the one that there has been since day one and its maximum from everybody and we continue to execute on that basis. Just as a reminder, the impact on capital of the local participation in the absolute worst scenario from extreme loss is about 30 basis points locally and another about 10 basis points on what remains of our cross border portfolio.

The last thing that I would like to say so that you have an idea if you look at net loans so net of provisions at constant effects our cross border exposure to Russia has gone down in five quarters 69% and our local 48% for a blended 54%. So I don't think you could ask from anybody to do something more decisively within obviously regulation and laws and everything else. And that's what we are going to continue to do maintaining the risk under control.

Stefano Porro

For Germany, we are expecting for this year GDP negative so slightly below zero around 0.3. Next year we are expecting to have a GDP growth in relation to the quality of the portfolio. The portfolio is really good if we look to the expected loss of the stock of the portfolio in Germany is 14 basis point 14 and also the origination, the new origination, the new business petal loss Q2 is similar to the one of Q1.

With regards to the dynamic of the default rate, I was commenting today the default rate of the group at 0.8% for Germany is below because it's 0.5% and is remaining below one. It was below one also last year it was 0.5%. Q1 is remaining 0.5 also this year. We are not expecting in the case of Germany for the forthcoming future, a meaningful deterioration of our portfolio.

Operator

The next question is from Delphine Lee with JPMorgan. Please go ahead.

Delphine Lee

Yes, good morning. Thanks for taking my questions. So my questions first one is on NII. Just coming back to the deposit mean your assumption does include a small acceleration in the increase in the pass through. So I was just wondering what you think are the main drivers for the acceleration. And then my second question is going back to excess capital. There's going to be a little bit of a gap on share buybacks between the second tranche of 1 billion and the one you're going to run for four year 23.

Is there any possibility, given where your CT One and NDA buffer stands to kind of already anticipate a buyback ahead of four year results announcement to start something that is maybe extraordinary buyback you talked about, complementing it and what's preventing you from starting other way now?

Andrea Orcel

Thank you. So I'll take the excess capital and the SBB and everything else. There's nothing stopping us. And everything is possible at the time being. It doesn't seem that the market is very sensitive to our distributions, but seriously, nothing is stopping us and we are reassessing the situation because one thing is to be consistent with our sustainable ordinary distribution and getting to a level that we are confident we can support over time.

The other thing is the correct judgment on two factors. One is how much cash dividend in the mix. And two is whether we should overlay earlier the return of the excess capital to our ordinary distribution or not and we are reviewing those topics all the time. And obviously the higher the excess capital, the more there is a, let's say, driver to consider extreme redistribution on top of the ordinary.

For the time being, there is no decision, nothing is stopping us beyond shareholder approvals and obviously ECB approval, but we are relatively comfortable on those on net interest income dynamic, especially in relation to the deposit beta assumption. Less are from the current situation. So. The average deposit beta is around 24%.

That's very differentiated by each country or geography. So Italy is around 11%. In the case of Germany, we are above 30%, Central Europe is around 35 and Eastern Europe is 25%. Andrea commented before in relation to the assumption for 2024, these are assumption.

So we are assuming to have a general deposit beta above the historical levels that for the group were between 30% and 35%, where we are assuming to be slightly below 40%. That means in every geography we are assuming to be above the historical levels. So to give you the sense, for example, in Germany and Central Europe we're assuming to be above 40%, while in Italy and Eastern Europe to be above 330. In 2024, in each geography we're assuming to be above historical levels.

The dynamic of the rates in terms of velocity was unprecedented. In some of the countries, the increase of the deposit beta is normalizing, so is moderating, and in some other country, like Italy, is low, is very low, is currently sticky and below the historical level. So that's why we think it's appropriate in terms of future projection to assume, let's say a normalization towards the level that we had many years ago and being conservative in terms of assumption as already allied before. If the dynamic will be different in comparison to this assumption, we will have tailwinds on the dynamic of the net interest income.

Operator

We will now take our last question from Hugo Cruz with KBW. Please go ahead.

Hugo Cruz

All right, thank you for the time. Just a clarification on some of the previous questions and comments. First off on NII, I understood you will assume that the beta will continue to go up after the end of this year. So you're ending at below 40%. So where do you think the average next year will be?

Second, on the capital distribution, are you also considering the potential introduction of an interim dividend or interim dividends? And then third, your comment on the sustainable RTE of 15%, is that net of the excess capital that you already have? So assuming, I would imagine a CTE ratio around 13% or is that with the excess capital included?

Andrea Orcel

So on interim dividends, I think it's premature for us. So no, we've discussed before, let's call them interim share buybacks. That's possible with respect to so that's on capital distribution, maybe you'll take the NII.

Stefano Porro

So the average for this year will be slightly below 30%. In terms of assumption is assuming a next hit rate in Q4 in terms of positive beta below 40%. While for next year we were assuming slightly below 40%. That's the average for the year. To be combined with the dynamic of the rates that is envisioning for next year and normalization. So in terms of interest rate average, the average can be similar in comparison to the one of this year, but we are assuming to have a next year rate at the end of 2024 in terms of your LIBOR, lower than the rate that we are assuming at the end of 2023.

Hugo Cruz

Thank you. Thank you very much.

Operator

So that was the last question. I turned the conference back to the UniCredit management for the closing remarks.

End of Q&A

Andrea Orcel

Thank you very much for your time, and we'll see you at the next quarter. Thank you.

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